

L A W O F F I C E S

2101 L Street NW • Washington, DC 20037-1526
Tel (202) 785-9700 • Fax (202) 887-0689

September 11, 2002

RECEIVED

Marlene H. Dortch, Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W. TW-A325
Washington, D.C. 20554

SEP 11 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: Impact of IXC Bankruptcies on a True-Up: Implementation of the Pay Telephone
 Reclassification and Compensation Provisions of the Telecommunications Act of
 1996, CC Docket No. 96-128

Dear Ms. Dortch:

A refund of dial-around compensation between interexchange carriers ("IXCs") and independent payphone service providers ("PSPs") for the Intermediate Period (October 7, 1997 – April 21, 1999) is unlawful since the bankruptcies of WorldCom and Global Crossing *guarantee* that such refunds would leave independent PSPs massively undercompensated for dial-around calls for both the Intermediate Period and Interim Period (November 7, 1996 - October 6, 1997) combined.¹ To avoid such a result, the Commission must reconsider its decision in *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Third Report and Order, 14 FCC Rcd 2545, 2636, ¶ 198 (1999) to order a refund for the Intermediate Period.

¹ Aside from the bankruptcies, APCC, through a series of *ex parte* submissions, has demonstrated, that based on other equitable factors, the Commission cannot justify ordering independent PSPs to refund any of the compensation they received for the Intermediate Period. In particular, the following equitable factors counsel against ordering such refunds: 1) independent PSPs were massively undercompensated in the Early Period; 2) independent PSPs failed to recover their costs in the Intermediate Period because they were compensated on only a fraction of calls; and 3) interexchange carriers have already recovered the cost of dial-around compensation from end users. Alternatively, APCC has urged the Commission to exclude independent PSPs entirely from the true-up, pointing out that independent PSPs would basically break even in a true-up for the Interim and Intermediate Periods, and including independent PSPs would needlessly complicate the true-up.

I. INTRODUCTION

As the Commission is well aware, the long-distance industry is in a financial crisis. Both WorldCom and Global Crossing have declared bankruptcy and there is speculation that Qwest might follow suit. This changed circumstance would have a tremendous impact on the true-up currently under consideration for the Interim and Intermediate Periods.

In the true-up currently under consideration, IXC's generally would pay additional compensation to PSPs for the Interim Period, to correct for the interruption of compensation when the court of appeals vacated the first payphone order.² For the Intermediate Period, by contrast, PSPs would refund compensation to IXC's to correct for the difference between the \$.284 rate initially set for that period and the \$.24 rate subsequently found to be a "fair" rate.

In this combined true-up, WorldCom and Global Crossing, on balance, would owe independent PSPs millions of dollars in additional compensation. This large amount of compensation owed by WorldCom and Global Crossing, combined with money owed by other IXC's for the Interim Period, more than offsets the money that independent PSPs would owe IXC's for the combined periods. However, because of the bankruptcies to WorldCom and Global Crossing, independent PSPs would be required to pay IXC's the compensation refund owed for the Intermediate Period (as well as AT&T's refund for the Interim Period), while unable to collect the large amount of money owed by WorldCom and Global Crossing for the Interim Period. Therefore, even though independent PSPs should on balance collect additional compensation for the combined periods, independent PSPs would actually end up paying millions of dollars on balance to IXC's.³ As a result, a

² AT&T is the only IXC that would on balance be owed money for the Interim Period. Allocation of IXC Shares, *Ex Parte* Letter to Marlene H. Dortch, Secretary, FCC, from Albert H. Kramer, Robert F. Aldrich and Robert N. Felgar at 9 (May 23, 2002). Updated Calculations of Intermediate Period Payments Adjusted to \$.238/Call, *Ex Parte* Letter to Marlene H. Dortch, Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich (July 11, 2002).

³ Significantly, independent PSPs would be required to pay money to IXC's in a true-up for the Interim and Intermediate Periods even if the Commission prohibits WorldCom and Global Crossing from collecting refunds from independent PSPs for the Intermediate Period. APCC's Chart re true-up Outcomes, in fact, assumes that WorldCom and Global Crossing may not collect any refunds if they do not pay any additional compensation for the Interim Periods. This is because the amount of money that these two carriers owed independent PSPs for the Interim Period is significantly greater than the amount of (footnote continued on next page)

true-up for the Interim and Intermediate Periods would leave independent PSPs compensated, on average, at a per-call rate of approximately \$.204 per call for the Interim and Intermediate periods combined,⁴ well below the \$.229 rate that the Commission stated is the lawful rate in *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Fourth Order on Reconsideration and Order on Remand, 2002 FCC LEXIS 513, ¶ 7 (2002) (“*Fourth Recon. Order*”).⁵ In other words, even though independent PSPs must be *paid money* on balance in order to be compensated at the lawful rate (i.e., at least \$.229 per call), a true-up for the Interim and Intermediate Periods would actually result in independent PSPs *paying* IXC’s thus making independent PSPs’ undercompensation even worse. The Commission *must consider* the effect of this changed circumstance in any decision it makes regarding whether and how to order a true-up. Failure of the Commission to consider the bankruptcies would amount to a failure of the Commission to “ensure that all payphone service providers are fairly compensated for each and every . . . call.” 47 U.S.C. § 276(b)(1)(A).

A more detailed discussion of the impact of the bankruptcies on a true-up is set forth in section II below.

II. THE EFFECT OF THE BANKRUPTCIES ON A POSSIBLE TRUE-UP WOULD BE SIGNIFICANT

A. Interim Period

In the event of a true-up, IXC’s as a group would owe independent PSPs approximately \$47.75 million for the Interim Period. See Possible True-Up Outcomes for PSPs Represented by APCC Services attached to Notice of *Ex Parte* Communication to Marlene H. Dortch, Secretary, FCC, from Robert N. Felgar (August 23, 2002) (“Table re

⁴ The \$.204 estimate assumes that independent PSPs were compensated on all calls during the Intermediate Period. In fact, independent PSPs were compensated on only a fraction of calls. See footnote 17 *infra*.

⁵ The *Fourth Recon. Order* adopted the \$.24 rate for a true-up with some adjustments. In particular, the Commission subtracted a cost element of \$.002 that was designed to provide carriers with a mechanism to recover the cost of installing FLEX ANI. In addition, for at least the Interim Period, the Commission subtracted a cost component of \$.009 that was included to reflect the time value of money during the typical four-month delay in payment to PSPs. *Fourth Recon. Order*, ¶¶ 7-10. But see APCC’s Petition for Reconsideration of the Commission’s Fourth Order on Reconsideration and Order on Remand at 2-9 (April 3, 2002) (arguing that the Commission should reinstate the \$.009 interest cost element in the rate applicable to retroactive adjustments of compensation).

True-Up Outcomes").⁶ This is largely because most IXC's paid independent PSPs little or no compensation after the court's decision in *Illinois Pub. Telecomm. Ass'n v. FCC*, 117 F.3d 555 (D.C. Cir. 1997), declaring the Commission's dial-around compensation scheme to be unlawful. WorldCom and Global Crossing alone account for well over half of the total amount owed to PSPs for the Interim Period.⁷ AT&T, on the other hand, would be owed a large refund.⁸ But on balance, as stated above, independent PSPs would be owed almost \$50 million of additional compensation for the Interim Period. See Table re True-Up Outcomes.

In reality, however, due to the bankruptcies of WorldCom and Global Crossing, independent PSPs would collect far less than \$50 million in additional compensation for the Interim Period. *Id.* Overall, while a true-up for the Interim Period should leave independent PSPs compensated at a rate of at least \$.229 per call,⁹ independent PSPs will in fact only be compensated at an average rate of approximately \$.161 per call.¹⁰

B. Intermediate Period

If the Commission ordered the true-up currently under consideration for the Intermediate Period, independent PSPs would owe IXC's as a group approximately \$37.25 million. See Table re True-Up Outcomes.¹¹ This amount would not change due to the

⁶ APCC's estimates of independent PSPs' and IXC's obligations in a true-up for the Intermediate Period were based on data submitted by the Regional Bell Operating Companies on dial-around calls in 4Q97.

⁷ The exact number can be calculated from the confidential version of Table re True-Up Outcomes.

⁸ The exact number can be obtained by inspecting the confidential version of Table re True-Up Outcomes.

⁹ But see APCC's Petition for Reconsideration of the Commission's Fourth Order on Reconsideration and Order on Remand (arguing that the appropriate compensation rate for purposes of the Interim and Intermediate periods should not be reduced below \$.238 per call.).

¹⁰ This per-call rate was calculated with the data provided in the attachments to Allocation of IXC Shares, *Ex Parte* Letter to Marlene H. Dortch, Secretary, FCC, from Albert H. Kramer, Robert F. Aldrich and Robert N. Felgar at 9 (May 23, 2002).

¹¹ APCC's estimates of the amount of compensation that independent PSPs would pay in the Intermediate Period are based on the difference between the \$.284 per-call rate that IXC's actually paid independent PSPs in the Intermediate Period and the \$.238 per-call rate that they should have paid.

bankruptcies since independent PSPs would presumably be obligated to pay WorldCom and Global Crossing in a true-up despite the fact that the carriers are bankrupt. Based on the Commission's determinations in the *Fourth Recon. Order and Third Report and Order*, a true-up for the Intermediate Period would theoretically leave independent PSPs compensated at a rate of at least \$.229 per call.¹²

C. Interim and Intermediate Periods Together

The effect of the bankruptcies on a true-up for the Interim and Intermediate Periods is clear. If there were no bankruptcies, IXC's would pay independent PSPs approximately \$10.5 million (the difference between the \$47.75 million independent PSPs are owed for the Interim Period and \$37.25 million that independent PSPs would pay IXC's for the Intermediate Period). See Table re True-Up Outcomes. However, because of the bankruptcies, independent PSPs would wind up *paying* IXC's an even larger amount.¹³ This dramatic swing in independent PSPs' payment obligations would occur because independent PSPs would still have to pay IXC's a significant amount of compensation refunds for the Intermediate Period, but would collect none of the additional compensation owed them by WorldCom and Global Crossing for the Interim Period.

Because independent PSPs would end up paying IXC's a balance of more than \$10 million (even though, "on paper" independent PSPs are actually owed a balance of \$10.5 million), a true-up is guaranteed to leave independent PSPs severely undercompensated for the Interim and Intermediate Periods. Instead of being compensated on average at the rate of \$.229 per call, independent PSPs would be

¹² But see APCC's Petition for Reconsideration of the Commission's Fourth Order on Reconsideration and Order on Remand (arguing that the appropriate compensation rate for purposes of the Interim and Intermediate Periods should not be reduced below \$.238). The statement that a true-up for the Intermediate Period should leave independent PSPs compensated at the rate of \$.229 assumes, however, that independent PSPs were compensated on average for 159 calls per phone, which APCC has demonstrated did not occur. See Retroactive Adjustment of Interim Compensation, Ex Parte Letter to Dorothy Attwood, Chief, Common carrier Bureau, FCC, from Albert H. Kramer and Robert F. Aldrich (March 26, 2001); Updated Calculations of Intermediate Period Payments Adjusted to \$.238/Call, Ex Parte Letter to Marlene H. Dortch, Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich (July 11, 2002). See also footnote 17 *infra*.

¹³ The exact number can be obtained by inspecting the confidential version of Table re True-Up Outcomes.

compensated on average at the rate of \$.204 per call.¹⁴ Thus, while the true-up for the Interim and Intermediate Periods is intended to ensure that PSPs are compensated at no less than the \$.229 rate prescribed by the Commission in the *Fourth Recon. Order*, in reality the bankruptcies *guarantee* that independent PSPs will be compensated on average at a *substantially lower* per-call rate. It would be legal error for the Commission to ignore the bankruptcies and order a true-up for the Interim and Intermediate Periods that it knows will necessarily result in the undercompensation of independent PSPs.

Ignoring the bankruptcies would be unlawful for at least three reasons. First, it would violate section 276 of the Act which requires that the Commission prescribe rules that “ensure” that PSPs receive fair compensation for each and every completed call. 47 U.S.C. § 276(b)(1)(A). Second, ignoring the bankruptcies would violate the well established principle that in resolving a question for a period which has already past, an agency cannot turn a blind eye to facts that have already transpired. Finally, ignoring the bankruptcies would be inconsistent with the Commission’s *Fourth Recon. Order*, which clearly intended that independent PSPs be compensated on average at a per-call rate of at least \$.229. Each of these is addressed below.

III. ORDERING A REFUND FOR THE INTERIM AND INTERMEDIATE PERIODS WOULD VIOLATE SECTION 276 OF THE ACT BY REDUCING THE AVERAGE PER-CALL RATE AT WHICH INDEPENDENT PSPS ARE COMPENSATED BELOW WHAT IS FAIR

Section 276(b)(1)(A) provides that “the Commission shall take all actions necessary . . . to prescribe regulations that . . . establish a per-call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed . . . call.” 47 U.S.C. § 276(b)(1)(A). The \$.229 rate, which is based on the \$.24 rate prescribed by the Commission in the *Third Report and Order*, is designed to ensure that “each call at a marginal payphone location recovers the marginal cost of that call plus a proportionate share of the joint and common costs of providing the payphone.” *Third Payphone Order* at 2571, ¶ 59. Since the \$.229 rate is designed to permit cost recovery and no more, an average compensation rate lower than \$.229 cannot be considered “fair.” Yet, because of the bankruptcies in the long-distance industry, if the Commission applies the \$.229 rate to the Interim and Intermediate Periods through a true-up, the Commission will not ensure fair compensation, but rather will *guarantee* that independent PSPs would on average be paid a per-call rate of substantially less than \$.229.

¹⁴ This rate is the weighted average of the \$.161 rate that would be the effective rate of compensation for the Interim Period, and the \$.229 rate that would be the effective rate of compensation for the Intermediate Period.

Because Section 276(b)(1)(A) requires the Commission to “ensure” fair compensation of PSPs, the Commission cannot order a true-up that it knows will provide *unfair* compensation.

Under these circumstances, the Commission should reconsider its order requiring independent PSPs to pay refunds for the Intermediate period and should require a true-up of independent PSPs’ compensation for the Interim Period only.¹⁵ Doing so would provide no wind-fall to PSPs, who would still owe AT&T a substantial refund for the Interim Period. If the Commission ordered a true-up only for the Interim Period, independent PSPs would be paid an amount that is within three million dollars of the \$10.5 million that independent PSPs would be paid if the Commission ordered a true-up for both the Interim and Intermediate Periods and WorldCom and Global Crossing were not bankrupt.¹⁶ In other words, if the Commission, to address the reality of the bankruptcies, reconsidered the Intermediate Period refund order and required independent PSPs to participate in a true-up for the Interim Period only, the Commission would place independent PSPs in roughly the same position that independent PSPs would have found themselves in had there been no bankruptcies and had the Commission ordered a true-up for both the Interim and Intermediate Periods.

IV. THE CASE LAW REQUIRES THAT THE COMMISSION FACTOR THE BANKRUPTCIES INTO ANY RATE USED FOR A TRUE-UP

When an agency prescribes a rate for a past period, it must consider actual facts that have occurred during or after the period in question and cannot blindly apply the same rate to the past as it does to the future. In other words, the agency must take into account available evidence regarding actual experience rather than relying solely on assumptions and projections as though it were establishing the rate *nunc pro tunc*. See *West Ohio Gas Co. v.*

¹⁵ APCC’s first choice is for there to be no true-up at all. As explained by APCC in detail in its Petition for Reconsideration of the Commission’s Fourth Order on Reconsideration and Order on Remand at 10-14, a true-up will involve thousands of PSPs and hundreds of IXC’s and will therefore be extremely complex and time consuming. The changes in names and ownership of IXC’s will make recovery from IXC’s impossible in many cases. Many independent PSPs will almost certainly be required to resort to litigation to recover the money owed them. In light of the passage of time and other factors, it may not be easy for some PSPs to prevail in such litigation. Accordingly, APCC would prefer that independent PSPs not be involved in a true-up for any period.

¹⁶ The exact amount of compensation that independent PSPs would be paid for the Interim Period can be obtained by inspecting the confidential version of Table re True-Up Outcomes.

Pub. Util. Comm' of Ohio, 294 U.S. 79, 80-82 (1935) (“*West Ohio Gas*”); *Moss v. Civil Aeronautics Bd.*, 521 F.2d 298, 308 (D.C. Cir. 1975); *Summerfield v. Civil Aeronautics Bd.*, 207 F.2d 200 (D.C. Cir. 1953) (“*Summerfield*”).

In *West Ohio Gas*, the Public Utilities Commission of Ohio (“PUC”) established in 1933 a schedule to be applied retroactively to the period August 1929 to February 1933. Collections by the utility between 1929-1933 in excess of that schedule were to be refunded to consumers. The schedule established by the PUC was designed to provide the utility with a rate of return on property of 6% during each of the four years at issue. To determine the schedule for all four years, the PUC looked only at the economic conditions of the utility in 1929 and projected forward to establish the schedule for the remaining years. The PUC ignored unchallenged evidence regarding the economic conditions in 1930 and 1931. The evidence of actual economic conditions demonstrated that the actual rate of return in 1930, based on the new schedule prescribed by the PUC, would be only 4.23% and the return in 1931 would be only 3.68%. The United States Supreme Court determined that the PUC could not ignore the evidence of actual economic conditions in 1930 and 1931.

The earnings of the later years were exhibited in the record and told their own tale as to the possibilities of profit. To shut one's eye to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guesswork with evidence available. There are times, to be sure, when resort to prophecy becomes inevitable in default of methods more precise. At such times, an honest and intelligent forecast of probable future values . . . is the only organon at hand, and hence the only one to be employed in order to make the hearing fair. But prophecy, however honest, is generally a poor substitute for experience.

West Ohio Gas at 82 (quoting *Southwestern Bell Tel. Co. v. Public Serv. Comm'n of Missouri*, 262 U.S. 276, 288 (1922)).

Similarly, if the Commission moves forward with a true-up by applying the \$.229 rate, the Commission cannot ignore the fact that due to the bankruptcies, independent PSPs would actually be paid on average only \$.204 per call, significantly less than the \$.229 determined by the Commission to be the “fair” rate.

In *Summerfield*, the United States Court of Appeals for the District of Columbia similarly held that when an agency sets a rate for a past period, the agency must rely on facts rather than projections, when such facts are available. *Western Air Lines* (“*Western*”) sold some property during a period for which the Civil Aeronautics Board had to

retroactively determine the amount of compensation that Western would receive for the transportation of mail. The amount of compensation that Western received depended to some extent on whether the profit from the sale of the property was counted as revenue. Compensation would be less if the profit from the sale of the property was counted.

Western argued that the profit from the sale of the property should not be counted. Western reasoned that “a rate-making proceeding must be, in contemplation of law, rate-making for the future – a prospective rate-making, since . . . rate-making is inherently a prospective concept.” *Summerfield*, 207 F.2d at 203. Thus, reasoned Western, since the profit from the sale of the property would not be factored into a prospective rate because no additional property sales were anticipated, the profit from the sale of the property should not be factored into a retroactive rate. The court, however, disagreed, stating that “when the period under consideration has passed, fair and reasonable rates should be ascertained from what is known and not from a *nunc pro tunc* estimate.” *Id.* at 204 (citing *West Ohio Gas*).

Moreover, in *Moss*, the court explained that even when a rate is declared to be unjust and unreasonable, a refund is not appropriate if changed circumstances make the refund inequitable. *Moss*, 521 F.2d at 308. An agency must consider changed circumstances prior to ordering a refund.

Similarly, in this case, the Commission cannot ignore the fact that circumstances have changed and that, due to those changed circumstances (*i.e.*, the bankruptcies), if the Commission were to order a true-up for both the Interim and Intermediate Periods, independent PSPs would not be compensated fairly for dial-around calls. Just as the court in *Ohio* held that the PUC could not ignore changed economic circumstances that would cause the utility, after paying refunds, to earn significantly less than the target rate of return, the Commission cannot ignore changed circumstances—IXC bankruptcies—that cause independent PSPs, after a true-up, to be undercompensated for dial-around calls. The Commission must base its decision on what is known rather than proceed *nunc pro tunc*. The courts in *West Ohio Gas* and *Summerfield* made it very clear that when faced with the choice of relying on projections and assumptions or facts, an agency must choose facts.¹⁷ The Commission, therefore must take the bankruptcies into account and cannot

¹⁷ Significantly, another incorrect assumption made in the *Third Report and Order* was that independent PSPs would be compensated on 142 dial-around calls from payphones in “marginal locations.” We now know, with the benefit of hindsight, that during the Intermediate Period independent PSPs were compensated on approximately 93 calls per marginal payphone per month, due to a number of factors outside their control. The result is that independent PSPs received compensation of approximately \$27.55 per month (93 x \$.284=\$26.42) for marginal payphones, rather than the \$33.80 intended by the (footnote continued on next page)

blindly assume that ordering a refund for the Interim and Intermediate Periods will ensure that independent PSPs are fairly compensated.

V. BECAUSE OF THE BANKRUPTCIES ORDERING A TRUE-UP FOR THE INTERIM AND INTERMEDIATE PERIODS IS NOT PERMITTED BY THE FOURTH RECON. ORDER

The Commission, in the *Fourth Recon. Order*, clearly intended that in the event of a true-up independent PSPs be paid an average per-call compensation rate of \$.229. As a result, applying the \$.229 rate to the Interim and Intermediate Periods, which would cause independent PSPs to be compensated on average at significantly less than \$.229, would violate the *Fourth Recon. Order*. The Commission's intent is clear from the fact that the \$.229 rate does not include an element for bad debt. The absence of an element for bad debt demonstrates that the Commission intends for independent PSPs to collect every penny of the \$.229 per call rate they are owed. The Commission's intent in this regard is also confirmed by the fact that the Commission determined that the \$.229 rate is the rate needed to ensure that "the current level of deployment of payphones" would not be "negatively affect[ed]" and would "promote Congress's goal of widespread deployment of payphones." *Third Report and Order* at 2552, ¶ 15. An average compensation rate of less than \$.229 is inconsistent with this objective.

VI. CONCLUSION

The Commission cannot lawfully order a true-up for the Interim and Intermediate Periods; a true-up would guarantee that independent PSPs would be

Commission in the *Third Report and Order*. If the Commission proceeded with a true-up at the \$.229 rate, independent PSPs' undercompensation would be made even worse ($93 \times \$0.229 = \21.30). In particular, if the Commission proceeded with a true-up for the Interim and Intermediate Periods, APCC estimates that independent PSPs would be compensated at an average per-call rate of \$.16 per call. Nevertheless, APCC has assumed for purposes of this letter that independent PSPs were compensated on all calls so that the Commission can focus exclusively on the effect of the bankruptcies on a true-up. For a more detailed analysis of this issue, see Letter to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, from Albert H. Kramer and Robert F. Aldrich re Retroactive Adjustment of Interim Compensation (March 26, 2001); Updated Calculations of Intermediate Period Payments Adjusted to \$.238/Call, *Ex Parte* Letter to Marlene H. Dortch, Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich (July 11, 2002). Once again, in making refund decisions the Commission cannot simply ignore experience and proceed as though independent PSPs will be compensated on 142 calls per payphone per month when it knows that is not the case.

Marlene H. Dortch
September 11, 2002
Page 11

undercompensated for these time periods.¹⁸ The only possible courses of action open to the Commission are to reconsider its decision in the *Third Report and Order* to order a true-up for independent PSPs, for the Intermediate Period, or not to involve independent PSPs in a true-up at all.

Sincerely,



Albert H. Kramer
Robert F. Aldrich
Robert N. Felgar

AHK/mjo

cc: Jeff Carlisle
Tamara Preiss
Lenworth Smith
Jon Stover
Lynne Milne
Craig Stroup
Linda Kinney
Jordan Goldstein
Dan Gonzalez
Matthew Brill
Joel Marcus

¹⁸ Such undercompensation will occur and will result in inequity without regard to the equitable factors APCC has discussed in earlier *ex parte* submissions.